No. 87-1877

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

STEVE HARTENSTINE,
Petitioner,

v.

SUPERIOR COURT OF CALIFORNIA FOR THE COUNTY OF SAN BERNARDINO, NORTH DESERT DISTRICT,
Respondent.

(BLUE CROSS OF CALIFORNIA, CALIFORNIA PHYSICIANS' SERVICE, d.b.a. BLUE SHIELD OF CALIFORNIA,
Real Parties in Interest)

On Petition for a Writ of Certiorari to the California Court of Appeal for the Fourth Appellate District, Division Two

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Employees Health Benefits Act preempts California insurer "bad faith" law when the state law conflicts with the insurance contracts procured by the federal government pursuant to the Act, and the Act provides that such insurance contracts preempt the conflicting state law.

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STATEMENT OF THE CASE

Respondents, Blue Cross of California and California Physicians' Service, d.b.a. Blue Shield of California,

adopt the findings of fact presented in the Court of Appeal's opinion. See Pet. App. A at 2-10.

Statutory and Regulatory Scheme

1. The Federal Employees Health Benefits Act ("FEHBA") is a comprehensive statutory scheme under which the federal government procures and administers health insurance benefits for federal employees as a fringe benefit of their employment. The FEHB Program provides health insurance for nearly four million active and retired federal employees and six million dependents across the country.

Congress has granted broad discretion to the United States Office of Personnel Management ("OPM") to administer the Program within a comprehensive statutory framework. 5 U.S.C. §§ 8901-8913 (1982 & Supp. IV 1986). H.R. Rep. No. 957, 86th Cong., 1st Sess. 3, *reprinted in* 1959 U.S. Code Cong. & Admin. News 2913, 2916. OPM has implemented the statute in two extensive sets of regulations. 5 C.F.R. pt. 890 (1988); 48 C.F.R. ch. 16 (1987).

a. OPM procures health insurance benefits for federal employees by contracting with numerous private insurance carriers.[1] 5 U.S.C. § 8902. OPM is empowered to contract for such benefits, limitations, and exclusions as OPM "considers necessary or desirable." 5 U.S.C. § 8902 (d). OPM publishes and distributes the annual statement of contract benefits for each health benefits plan. 5 U.S.C. § 8907.

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[1] OPM contracted with the Blue Cross and Blue Shield Association in 1960 to establish the Government-wide Service Benefit Plan, one of the plans specified in section 8903 of the FEHBA. The Association is a nonprofit membership association of local member Blue Cross and Blue Shield Plans. The local Plans, including respondents Blue Cross of California and Blue Shield of California, underwrite and administer the Service Benefit Plan.

b. The FEHB Act and regulations establish a complete remedial scheme for resolving claims disputes between the insurance carriers and the federal employees. Individual claims under a given plan are initially submitted to the carrier for that plan. 5 C.F.R. § 890.105. Disputed claims are subject to review by the carrier and then by OPM. *Id.* The FEHBA provides that the carrier *must pay* a claim which OPM finds to be payable under the terms of the carrier's contract. 5 U.S.C. § 8902(j). The House Report accompanying the enactment of section 8902(j) states that Congress concluded that OPM's administrative review process would provide an "adequate administrative remedy for Federal employees" and would spare them from being "forced into the courts" to recover benefits due them. H.R. Rep. No. 459, 93d Cong., 1st Sess. 2, 7 (1973). Beneficiaries who disagree with OPM's determination are provided a federal law remedy. They may bring a lawsuit against the carrier "to recover on a claim for health benefits." 5 C.F.R. § 890.107.

The FEHBA also creates an administrative scheme for correction of any systematic abuses in claims processing by the carriers. Under the FEHBA, OPM is authorized to prescribe minimum standards of conduct for FEHB plan carriers and to withdraw approval of their plans if the carriers do not properly discharge their contract obligations. 5 U.S.C. § 8902(e); 5 C.F.R. § 890.204. OPM also is required to perform continuing audits of the operation and administration of the FEHB plans. 5 U.S.C. § 8910(a); 5 C.F.R. § 890.202(d).

2. The federal government pays approximately sixty percent of the annual cost of the FEHB Program. 5 U.S.C. § 8906(b). In 1987, the cost of the Program exceeded six billion dollars. Consequently, cost containment has always been of paramount concern for Congress and OPM. In order to maximize cost containment, Congress has delegated to OPM complete fiscal control over the

FEHB Program. 5 U.S.C. §§ 8902(i), 8906(a), and 8909. Pursuant to its authority, OPM has supplemented the federal acquisition regulations with comprehensive FEHB procurement regulations that control all expenditures of costs by the carriers. 48 C.F.R. ch. 16.

As part of its cost containment strategy, Congress specified, at the time of the FEHBA's enactment in 1960, that one of OPM's most important goals should be to provide the maximum benefits possible for the lowest cost. H.R. Rep. No. 957, *supra*, at 4, *reprinted in* 1959 U.S. Code Cong. & Admin. News at 2916. Consistent with that priority, Congress repeatedly has urged OPM and the carriers to ensure that benefit payments are limited to those allowed under the contracts.[2]

3. In 1978, in order to protect OPM's authority over the FEHB Program and to ensure nationwide uniformity in providing health benefits to federal employees, Congress amended the FEHBA to expressly preempt state laws that conflict with the terms of the FEHB contracts:

> The provisions of any contract under this chapter which relate to the nature or extent of coverage or benefits (including payments with respect to benefits) shall supersede and preempt any State or local law, or any regulation issued thereunder, which relates to health insurance or plans to the extent that such law or regulation is inconsistent with such contractual provisions.

5 U.S.C. § 8902(m)(1).

In its report on the legislation, the House Committee stated that it "concurred" in the view of OPM that the FEHB Program "should not be subject to alteration or regulation by State legislatures or State insurance

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[2] *See, e.g.*, Report by the Comptroller General of the United States, HRD-76-174 "More Civil Service Commission Supervision Needed to Control Health Insurance Costs for Federal Employees" (Jan. 14, 1977).

boards." H.R. Rep. No. 282, 95th Cong., 1st Sess. 4 (1977). Congress enacted § 8902(m)(1) for the "sole purpose" of establishing "uniformity in benefits and coverage under the Federal employees' health benefits program." S. Rep. No. 903, 95th Cong., 2d Sess. 2, *reprinted in* 1978 U.S. Code Cong. & Admin. News 1413 (Appendix "F"); H.R. Rep. No. 282, *supra*, at 1.

ARGUMENT

Respondents, California Blue Cross & Blue Shield Plans, agree with petitioner (albeit for different reasons) that this case presents an important preemption issue. But because the court below correctly decided the issue, and because there is no conflict among the appellate courts, review by this Court is not warranted.

1. This case presents the important question of what role, if any, state law should play in a federal program which provides health benefits for federal employees and which is administered and heavily subsidized by the federal government. OPM views this issue as a matter of "vital interest." *See* Amicus Brief for OPM at 3, *Hartenstine v. Superior Court of California*, 196 Cal. App. 3d 206, 241 Cal. Rptr. 756 (1987) (No. EOO 3956). In fact, OPM was sufficiently concerned about the "intolerable State" interference in the administration of the Program that it urged enactment of the FEHBA preemption provision more than ten years ago.

This case is also important because the FEHB Program is the only remaining health insurance program established under federal law in which the preemption of state laws governing "bad faith" claims processing under state law has not been settled. Since this Court's decisions in *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202 (1985), and *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987), the health insurance claims of virtually every employee in the United States are subject exclusively to

federal law.[3] But the law applicable to the insurance claims of federal employees is not settled and is being litigated on a piecemeal basis, despite the fact that OPM urged enactment of the FEHBA preemption provision more than ten years ago in order to avoid "time consuming and costly litigation." At this point in time, only one state supreme court and two federal courts of appeals have held that state bad faith laws are preempted by the FEHBA. *See* discussion, *infra* at p. 13.

2. The decision of the California Court of Appeal, holding that California's bad faith laws are preempted by the FEHBA, is correct. The legislative history of the FEHBA, the plain language of the preemption provision, and the FEHBA's structure and purpose support the Court of Appeal's decision. Moreover, the Court of Appeal's decision is consistent with OPM's interpretation of the preemption provision as presented in its *amicus* brief submitted to the court below. *See also* Brief for the Federal Respondent in Opposition at 9, *Hayes v. Prudential Ins. Co. of America*, 819 F.2d 921, 924 (9th Cir. 1987), *cert. denied*, 108 S. Ct. 1014 (1988) (No. 87-818) (where the Solicitor General stated that the FEHBA preempts these California tort laws, and opposed review by this Court, in part, because of procedural problems in the case).

a. As this Court has stated, "'[T]he question whether a certain state action is pre-empted by federal law is one of congressional intent. . . . The purpose of Congress is the ultimate touchstone.'" *Pilot Life*, 107 S. Ct. at 1552, *quoting Allis-Chalmers*, 471 U.S. at 208. One indication of congressional intent with respect to the FEHBA is that in enacting the preemption provision, Congress took the unique step of causing the *terms of the health benefits contracts* to preempt state law. It is difficult to con-

[3] The only significant exceptions are employees not covered by ERISA (employees of state and local governments and certain church groups).

ceive of a more explicit direction that FEHBA preemption should be broad and that authority over the terms and conditions of the health benefits contracts rests with OPM, who promulgates the contract terms, not with the states.

Another indication of congressional intent to free the FEHB Program from state interference is found in the legislative history of the FEHBA preemption provision. In urging enactment of the preemption provision, OPM reported to Congress that various state laws were causing administrative problems and lack of uniformity of benefits among federal employees, threatening to make it intolerable to administer the Program. S. Rep. No. 903, *supra*, at 7-8, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 1418-19; H.R. Rep. No. 282, *supra*, at 6-7. Congress agreed with OPM that the Program should not be subject to interference by the states. H.R. Rep. No. 282, *supra*, at 4. It expressed concern that imposition of state law requirements on FEHB Program contracts would defeat the federal goals of cost containment and uniform treatment of federal employees because state laws could "be expected to result in":

> Increased premium costs to both the Government and enrollees, and . . . .
>
> A lack of uniformity of benefits for enrollees in the same plan which would result in enrollees in some States paying a premium based, in part, on the cost of benefits provided only to the enrollees in other States.

Id.; *see also* S. Rep. No. 903, *supra*, at 2-4, 9, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 1413-16, 1420.

Congress defined the scope of the preemption it sought. The House Report states the preemption would include state laws which

> specify types of medical care, providers of care, extent of benefits, coverage of family members, age

> limits for family members, *or other matters relating to health benefits or coverage* when such laws or regulations conflict with the provisions of [FEHB] contracts. . . .

H.R. Rep. No. 282, *supra*, at 4-5 (emphasis added). The House Committee made clear that the provision would not apply to state laws "relating to the taxation of health insurance carriers or to the maintenance of special reserves." H.R. Rep. No. 282, *supra*, at 5; *see also* S. Rep. No. 903, *supra*, at 5, *reprinted in* 1978 U.S. Code Cong. & Admin. News at 1416.

Thus, Congress announced the distinction between those laws it intended to preempt and those it did not. Congress intended to preempt state laws that would interfere with federal control over and national uniformity in the provisions of the health plans in order to ensure uniform administration and uniform treatment of federal employees wherever they resided. Also, Congress intended to preempt state laws which would increase costs. Conversely, Congress made clear that it did not intend to preempt state laws that only affected internal corporate matters relating to the insurers, with no impact on the FEHB plans or individual subscribers, and it carved out an exception from preemption for state laws governing corporate reserves or state taxes.

Unquestionably, the California "bad faith" laws are in the category of laws that Congress intended to preempt. As discussed below, they affect the provisions of the health plans, create nonuniformity among federal employees, and increase costs.

b. The plain language of the FEHBA preemption provision compels a finding that California's bad faith laws are preempted. Under the FEHBA preemption provision, state laws are preempted if (1) they "relate to" FEHB plans; (2) they conflict with the terms of FEHB contracts; and (3) those conflicts "relate to benefits" or "pay-

ments with respect to benefits." 5 U.S.C. § 8902(m)(1). California bad faith law meets each of these tests. Moreover, the analysis under section 8902(m)(1) coincides with the analysis and holding in two recent decisions of this Court, finding preemption of similar state laws under analogous federal statutes. *See Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987), and *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202 (1985).

i. First, the California laws "relate to health insurance or plans" as required by section 8902(m)(1). This Court reaffirmed the meaning of "relate to" in *Pilot Life Ins. Co. v. Dedeaux*, where this Court held that a similar state bad faith tort "related to" ERISA plans because it had "a connection with or reference to such [plans]." 107 S. Ct. at 1553. Mr. Hartenstine's tort claims arising from the alleged breach of an FEHB insurance contract certainly have "a connection with or reference to" "health insurance or plans." Therefore, they relate to health insurance or plans" and are preempted.

ii. Second, the California laws are preempted by the FEHBA because they conflict with the FEHB contracts by implying a state-law-based duty of good faith and fair dealing into the contracts and by permitting the award of extracontractual damages not provided for in the contracts.

In the absence of preemption, the California laws imply a duty of good faith and fair dealing into insurance contracts. *See, e.g., Silberg v. Cal. Life Ins. Co.*, 11 Cal. 3d 452, 113 Cal. Rptr. 711, 521 P.2d 1103 (1974). Such implication of terms and duties into FEHB contracts is clearly prohibited by section 8902(m)(1). Where the FEHB contracts are silent, a state may not inject its own provisions, whether they be particular mandated health benefits or duties of good faith. Any other interpretation would simply vitiate the FEHB preemption provision, the purpose of which is to prohibit

states from changing the terms of FEHB contracts and to ensure uniform contract terms and duties nationally.

This Court's recent decision in *Allis-Chalmers* provides a compelling analysis under another federal contract scheme that virtually dictates the result under the FEHBA. In *Allis-Chalmers*, this Court held that state laws cannot inject implied duties of good faith into insurance contracts governed by the Labor Management Relations Act ("LMRA"). This Court noted that the state bad faith laws frustrate the policy of uniform contract interpretation underlying the federal contract scheme established by section 301 of the LMRA, inasmuch as the evaluation of state-law-based rights and obligations is inextricably intertwined with consideration of the terms of the insurance contract. 471 U.S. at 213-16. Therefore, this Court held that because federal law is to govern the meaning of terms in a federal labor contract, and because "the state tort purports to give life to [the contract] terms in a different environment," the state tort is preempted under the LMRA. *Id.* at 219.

The *Allis-Chalmers* decision is directly applicable to the issue of federal preemption under the FEHBA and requires a finding of preemption of state bad faith laws under the FEHBA. First, like the federal labor contract in *Allis-Chalmers*, FEHB contracts are governed by federal law. Federal law applies to FEHB contracts because FEHB contracts are federal procurement contracts. *United States v. Allegheny County*, 322 U.S. 174 (1944). Furthermore, FEHB contracts are imbued with the same federal concerns for uniform contracts interpretation as this Court found underlie contracts governed by the LMRA. In addition, the state-law-based causes of action alleged by the petitioner are identical in purpose and effect to the state law at issue in *Allis-Chalmers*, 471 U.S. at 214-16. The California laws "purport[] to define the meaning of the contract relationship," *id.* at 213, and, therefore, are preempted by the FEHBA.

The second conflict between the California laws and FEHB contracts arises because the state laws permit the award of extracontractual damages over and above the amount of benefits claimed under an FEHB contract. Such damages are not authorized under the FEHBA, the regulations, or the contracts.

The Fourth Circuit recently examined this conflict in *Myers v. United States* and correctly concluded that the FEHBA precluded recovery of extracontractual damages because such damages are not authorized: "a state law which purports to allow recovery of additional benefits not contemplated by a federal insurance contract must be deemed inconsistent." 767 F.2d 1072, 1074 (4th Cir. 1985).

iii. Third, the conflicts between the California laws and the FEHB contracts require preemption because the conflicts "relate to the extent of benefits" or "payments with respect to benefits" as provided in section 8902(m)(1). In the absence of preemption, California law would inject terms into FEHB contracts, terms which would establish duties of the Blue Cross and Blue Shield Plans concerning payments of benefits and which would enable Mr. Hartenstine to obtain payments with respect to his claim for contract benefits to which he is not entitled under the terms of the federal contract. As such, the "connection with or reference to" the "extent of benefits" and to the "payments with respect to benefits" is clear. *See Allis-Chalmers*, 471 U.S. at 213-16 (state tort is inextricably intertwined with contract).

c. Looking to "the provisions of the whole law, and to its object and policy," *Pilot Life*, 107 S. Ct. at 1555, it is clear that Congress intended to preempt state tort laws. As this Court found under ERISA, the FEHBA remedial scheme evidences the congressional intent to extend preemption to precisely those state laws, such as the California laws at issue here, that interfere with the

FEHB Program by substituting a non-uniform and costly state law remedy for the federal remedial scheme. Further evidence of congressional intent to preempt is provided by the FEHBA's twin objectives of uniformity and cost containment.

i. Under the FEHBA, Congress and OPM have established a comprehensive scheme, administered by OPM and monitored by Congress, to oversee carriers and their claims processing and to resolve claims disputes. This scheme is fully as comprehensive as ERISA's. Indeed, the federal interest and involvement in FEHB plans is clearly greater than in the private health plans governed by ERISA, which involve private employees of private companies and are administered by private persons.

Just as this Court found under ERISA, the existence of such a remedial scheme provides compelling evidence that Congress did not intend that a state remedial scheme operate with respect to the FEHB Program. *See Pilot Life*, 107 S. Ct. at 1555-56 (state tort poses obstacle to policies of ERISA by undermining ERISA enforcement scheme). *See also Allis-Chalmers*, 471 U.S. at 219-20 (state tort undermines arbitration remedy).

ii. This conclusion is even more compelling when considered in light of Congress' clear command that health benefits be uniform for federal employees nation-wide—a policy objective which is less significant under ERISA. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985). The injection of a remedial scheme under California bad faith law would enable California residents to pursue state remedies and obtain state law relief unavailable in other states.[4]

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[4] State-law-based torts and statutes similar to California's have not been uniformly adopted in the states. W. Shernoff, S. Gage & M. Levine, *Insurance Bad Faith Litigation*, Ch. 1 (Matthew Bender 1987).

iii. The entire FEHB scheme is predicated on OPM's control of costs, both for the benefit of the government and for the federal employees. *See NFFE v. Devine*, 679 F.2d 907, 912 (D.C. Cir. 1981). Awards of punitive damages would directly contravene this congressional directive to OPM by diverting scarce federal dollars from the purchase of maximum protection for all employees into awards to individual plaintiffs in certain states. *See* H.R. Rep. No. 957, *supra*, at 4, *reprinted in* 1959 U.S. Code Cong. & Admin. News at 2916.

3. The decision below by the California Court of Appeal is consistent with the decisions of all appellate courts that have considered the question. For the information of the Court, the Solicitor General also takes the position that no appellate conflicts exist on this preemption question. *See* Brief for the Federal Respondent in Opposition at 9, *Hayes v. Prudential Ins. Co. of America*, 819 F.2d 921.

Two federal circuit courts, including the Ninth Circuit, and one state Supreme Court have addressed the specific issue presented in this case, and each of them has found preemption. *Hayes v. Prudential Ins. Co. of America*, 819 F.2d 921 (9th Cir. 1987) (preemption of California state bad faith laws); *Myers v. United States*, 767 F.2d 1072, 1074 (4th Cir. 1985) (preemption of state bad faith law awarding attorneys' fees); *Nitschke v. Blue Cross of Montana*, 751 P.2d 175 (Mont. 1988) (preemption of state tort law).

Howard v. Group Hosp. Servs., 739 F.2d 1508 (10th Cir. 1984), cited by petitioner, is not to the contrary. *See* Brief for the Federal Respondent in Opposition at 10, *Hayes v. Prudential Ins. Co. of America*, 819 F.2d 921 (where the Solicitor General stated that *Howard* does not confiict with *Hayes*, a case presenting the identical issue presented to this Court for review here). In *Howard*, the court did not address the issue of whether the

FEHBA preempts state bad faith laws; instead, it held that an action for benefits denied under the FEHBA cannot be removed to federal court. This decision is incorrect and now against the weight of authority. *See, e.g., Tackitt v. Prudential Ins. Co. of America*, 758 F.2d 1572 (11th Cir. 1985).

There also is no conflict between this case and *Fields v. Blue Shield of California*, 163 Cal. App. 3d 570, 209 Cal. Rptr. 781 (1985). In *Fields*, the court did not address the issue of whether the FEHBA preempts state tort laws; instead it merely upheld the jury's finding of fact that no bad faith had occurred. The California Supreme Court, by refusing to grant review of *Hartenstine*, appears to agree that *Hartenstine* and *Fields*, two intermediate court decisions, do not conflict. Moreover, as in *Howard*, the holding in *Fields* concerning the interpretation of an FEHB contract provision is contrary to federal court decisions interpreting the same FEHB contract provision and is patently wrong. *See, e.g., Tackitt v. Prudential Ins. Co. of America*, 758 F.2d 1572.

The only case which conflicts with the decision of the court below is *Eidler v. Blue Cross & Blue Shield United of Wisconsin*, 671 F. Supp. 1213 (E.D. Wis. 1987). This district court opinion is out of step with the emerging case law, as discussed above, and a motion for reconsideration is pending.[5]

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[5] Motion for Reconsideration of Denial of Defendant's Motion for Summary Judgment, No. 86-C-1073 (Feb. 1, 1988).

CONCLUSION

For these reasons, the respondents believe that review of this case by this Court is not warranted.

Respectfully submitted,

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